No. 17041

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

[illegible] Trustee in Bankruptcy of the Bankrupt Estate of [illegible],

Appellant,

vs.

[illegible] National Trust and Savings Association, etc.,

Appellee.

APPELLANT'S OPENING BRIEF.

[illegible]
215 West Seventh Street,
Los Angeles 14, California,
Attorney for the Trustee-Appellant.

[illegible] Co., Inc., Law Printers, Los Angeles, Phone MA 6-9171

TOPICAL INDEX

TABLE OF AUTHORITIES CITED

Cases

Rules

Statutes

No. 17039

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

A. E. MALLAGH, Trustee in Bankruptcy of the Bankrupt Estate of ORVILLE STANFORD, INC.,

Appellant,

vs.

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, etc.,

Appellee.

APPELLANT'S OPENING BRIEF.

Jurisdictional Basis.

This is an appeal from a final Judgment made and entered in the United States District Court for the Southern District of California, Central Division and this Appeal is prosecuted in accordance with the provisions of Rule 72 *et seq.* of the Federal Rules of Civil Procedure.

On July 17, 1958, Appellant filed his Complaint in the United States District Court for the Southern District of California [Clk. Tr. pp. 3-7]. The Defendant Appellee, Bank of America, filed its Answer to the Complaint and its First Amended Answer thereto [Clk. Tr. pp. 8-11; 15-17].

On July 15, 1960, Plaintiff Appellant filed a Motion for Summary Judgment accompanied by Affidavits [Clk. Tr. pp. 24-28].

Thereafter, the Defendant filed counter-Affidavits and a Motion to Dismiss the Complaint [Clk. Tr. pp. 29-32].

Both Plaintiff and Defendant thereupon filed further Affidavits in support of the Motion for Summary Judgment and the Motion to Dismiss [Clk. Tr. pp. 33-39].

The United States District Judge, the Honorable Peirson Hall, made an Order denying Plaintiff's Moton for Summary Judgment and granting Defendant's Motion to Dismiss without leave to amend [Clk. Tr. p. 42].

Because the Order of the United States District Judge went only to the First Claim, a Stipulation for Judgment was made by and between the parties and a Judgment pursuant to the Stipulation made and entered by the United States District Judge. The second claim was dismissed without prejudice [Clk. Tr. pp. 43-45].

Plaintiff Appellant thereupon filed a Notice of Appeal to the above entitled Honorable Court [Clk. Tr. p. 45].

Statement of the Case.

This was an action at law commenced by the Trustee in bankruptcy to recover from the Defendant, Bank of America, upon a complaint filed in the United States District Court, based upon two (2) claims or causes of action. The First claim is to recover moneys paid to the Bank under a void Chattel Mortgage, the Chattel Mortgage being void as to a Trustee in Bankruptcy and as

to creditors for the failure of the Bank to record the Mortgage in the County where the personal property was removed. The property concerned was a portable oil drilling rig.

The Second claim is based upon a preference under Sections 60a and 60b of the Bankruptcy Act. Since this claim was dismissed without prejudice it is not under consideration on this appeal.

In the course of the proceedings before the trial Judge the Plaintiff, Trustee in Bankruptcy, filed a Motion for Summary Judgment and the Defendant Bank responded with counter affidavits and by filing a Motion to Dismiss the First Cause of Action. The Motion for Summary Judgment and the counter motion for dismissal was directed to the First Cause of Action only.

It is believed that the only issues in the case are legal. The facts are as follows:

A. E. Mallagh, Plaintiff is the Trustee in Bankruptcy of the bankrupt estate of Orville Stanford, Inc., a California corporation. A voluntary Petition in Bankruptcy was filed by this corporation in the United States District Court for the Southern District of California on February 20, 1958.

Sometime during the month of September, 1956, the bankrupt concern, which was engaged in oil drilling and related activities, entered into a loan transaction with the Bank of America and in connection with this transaction, executed a Promissory Note and a Mortgage of Chattels covering a portable oil drilling rig and accessories used in their drilling operations. The principal office of the bankrupt concern was located in Santa Barbara County and the Mortgage was recorded in Santa Barbara County.

Sometime in October of 1957, the drilling rig and the accessories were moved to Kern County under a lease arrangement with a local firm in that area. The property remained in Kern County from October 8, 1957 until January 10, 1958, approximately six weeks before bankruptcy, at which time the personal property was sold by the bankrupt concern for a total gross consideration of Twenty-six Thousand Five Hundred Dollars ($26,500.00). The transaction for this sale was handled by defendant Bank of America who received the total consideration, deducted the sum of Thirteen Thousand Nine Hundred Forty-nine Dollars and Twenty-five Cents ($13,949.25) (being the balance due upon the loan for which the Chattel Mortgage was given as security) and then remitted the balance after other deductions to the bankrupt concern.

The Bank of America did not at any time record its Chattel Mortgage in Kern County, nor did the Bank file with the Secretary of State in accordance with the provisions of 2965 of the Civil Code of the State of California.

There are creditors of the bankrupt concern whose claims rose prior to the time that the personal property was removed to Kern County in October of 1957. These same creditors remain unpaid as of the date of the filing of the Petition in Bankruptcy and these creditors have filed claims in the bankruptcy proceedings.

On or about June 11, 1958, Plaintiff herein made a written demand upon the Defendant, Bank of America, for the return of the sum of Thirteen Thousand Nine Hundred Forty-nine Dollars and Twenty-five Cents ($13,949.25). This demand was refused, action at law followed.

ARGUMENT.

POINT ONE.

The Chattel Mortgage of the Bank of America Was Void Under California Law as to Creditors and Is Void as to the Trustee in Bankruptcy.

The first claim of appellant is that the Bank received certain funds as the holder of the chattel mortgage on personal property, said chattel mortgage being void for the reasons set forth in the complaint. It is the position of the Appellant herein that such a void mortgage confers absolutely no rights upon the defendant, Bank of America, and that the moneys received by virtue thereof are an asset of the bankrupt estate to be distributed among all the creditors of the estate, equally, and pro-rata.

The complaint seeks to avoid the chattel mortgage and to have the same declared void and to recover the moneys paid by the bankrupt by virtue of the provisions of the California Civil Code with respect to chattel morgages covering personal property.

It is believed that the case at Bar is on all fours with the principles enunciated in two recent cases which were decided in this Circuit. Those cases (which will be referred to later in this Brief), are as follows:

Miller v. Sulmyer (C. A. 9, 1959), 263 F. 2d 513;

Chapman v. England (C. A. 9, 1956), 231 F. 2d 606.

The pertinent provisions of the California Civil Code are:

Section 2957, Subdivision 4, which reads as follows:

> "A mortgage of personal property or crops is void as against creditors of the mortgagor and subsequent purchasers and encumbrancers of the property in good faith and for value, unless . . .
>
> 4. The mortgage, if of personal property other than crops growing or to be grown or animate personal property, is recorded in the office of the recorder of each of the counties where the property mortgaged is located and where the mortgagor resides at the time the mortgage is executed, provided that in case the mortgagor is a non-resident of this State no recordation where the mortgagor resides is required, *and, in case the property mortgaged is thereafter removed to another county of this State, either the mortgage is recorded in that county or there is or has been filed a statement of recordation as prescribed in Section 2965;*" (Emphasis supplied.)

and Section 2965 of the Civil Code, Subdivisions 1, 2, and 3, which read as follows:

> "When personal property mortgaged (other than animate personal property mortgaged by a resident of this State, and motor vehicles and other vehicles defined in and the mortgaging of which are regulated by the California Vehicle Act) is removed from the county in which it is situated, constructive notice of the mortgage imparted by recordation shall not be affected thereby for 30 days after such removal; but, after the expiration of such 30 days, said recordation shall not impart constructive

notice while said property remains removed from the county:

1. Until the mortgagee causes the mortgage to be recorded in the county to which the property has been removed; or

2. Unless the mortgage causes or has caused a statement of recordation to be filed; or

3. Until the mortgagee takes possession of the property as prescribed in the next section."

In 1931, in *Moore v. Bay,* 284 U. S. 4, the United States Supreme Court established by unanimous opinion two fundamental principles of bankruptcy law:

First, that when under state law a transaction is voidable or void to any extent by a creditor of the bankrupt having a provable claim, the transfer is entirely void as to the Trustee in Bankruptcy. That is to say, the extent of the Trustee's recovery is not limited to the amount of the claims upon which he relies in attacking the transfer.

Second, that the recovery thus made by the Trustee, is to be distributed *pro rata* to all creditors of the bankrupt, in accordance with the distributive provisions of the Bankruptcy Act, and not only to those creditors who might have attacked the transfer outside of bankruptcy. While the Supreme Court's decision was rendered in the characteristically brief style of Mr. Justice Holmes, analysis of the opinion of the Ninth Circuit, *In re Sassard & Kimball,* 45 F. 2d 449 (C. A. 9, 1930), which was reversed *sub nom. Moore v. Bay,* leaves no doubt that the holding established both the foregoing propositions. Since 1931, there has not been a single Court of Appeals or Federal District Court which has denied the

rule that a transaction void or voidable in part by creditors of the bankrupt, is completely void under Section 70e of the Bankruptcy Act as against the Trustee in Bankruptcy. Thus, the Second Circuit stated in *City of New York v. Rassner,* 127 F. 2d 703, 707 (C. A. 2, 1942):

> '". . . in many cases chattel mortgages are valid as against some creditors and not others; and yet ever since Moore v. Bay, 284 U. S. 4, 52 S. Ct. 3, 76 L. Ed. 133, 76 A. L. R. 1198, it has been considered proper to invalidate a mortgage *in toto* even though the only creditor entitled to invalidate has an insignificant claim, and proper to distribute the proceeds among all the creditors."'

The Fourth Circuit in *Friedman v. Sterling Refrigerator Co.,* 104 F. 2d 837, 840 (C. A. 4, 1939), held:

> '". . . it is held that a claim which for want of record is void as against some but not all of the creditors of the bankrupt may be avoided *in toto* by the trustee in bankruptcy, even though creditors generally benefit by the avoidance."' (Trustee relied upon a provable claim of $14.23 to set aside a security transaction involving more than $500.00).

Likewise, the Fifth Circuit has held in *Corley v. Cozart,* 115 F. 2d 119, 121 (C. A. 5, 1940):

> '"The bill of sale to secure debt, being admittedly invalid as against subsequent creditors without notice, was properly held to be invalid in its entirety on objection of the Trustee in Bankruptcy. A claim void against some of the creditors of a bankrupt may be avoided in its entirety by the Trustee even though creditors generally benefit by the avoidance."'

POINT TWO.

The Trustee Has the Right and the Duty to Recover the Moneys Paid to the Appellee Bank.

The pertinent sections of the Bankruptcy Act under which the Trustee in Bankruptcy proceeded are Sections 70c and 70e.

> 70c. "The trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitations, statutes of frauds, usury and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The *Trustee,* as *to all property whether or not coming* into *possession or control of the court upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings whether or not such a creditor actually exists.*" (Italics supplied.)
>
> 70e. "A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor."

The leading case on the interpretation of these sections is the case of *Constance v. Harvey* (C. A. 2, 1954), 215 F. 2d 571; cert. den., 348 U. S. 913. The rights of a trustee as a so-called "ideal creditor" has also been

interpreted in this Circuit is the case of *England v. Sanderson* (C. A. 9, 1956), 236 F. 2d 641. This case involved the interpretation of the California statute increasing the homestead exemption. The court said in connection with this ruling at page 643:

> "[3] The trustee is given under Sec. 70 sub. c of the Bankruptcy Act all the rights, remedies and powers of a hypothetical creditor holding a lien obtained by legal or equitable proceedings at the time of bankruptcy. . . ."

For examples of cases in other districts wherein the trustee was set aside chattel mortgages or recovered property for the benefit of the estate where void chattel mortgages were concerned, see the case of *In re Consorto Construction Company* (C. A. 3, 1954), 212 F. 2d 676. See further the case of *Zamera v. Goldblatt* (C. A. 2, 1952), 194 F. 2d 933, cert. den., 343 U. S. 979. See finally the case of *In re Kranz Candy Company* (C. A. 7, 1954), 214 F. 2d 588.

It should be observed that in the interpretation of Section 70c of the Bankruptcy Act, the trustee's rights will vary from state to state insofar as the rights of creditors themselves vary according to the law of the state where the transaction occurred. The reason for this and the nature of this so-called dichotomy in federal and state laws is set forth in the case of *In re Driscol* (S. D. Cal. 1954), 127 Fed. Supp. 81, where the court in quoting from another case said at page 62:

> "This Dichotomy between federal and state law is succinctly stated in Commercial Credit Co. v. Davidson, 5 Cir. 1940, 112 F. 2d 54, 55: 'We are controlled by federal law in determining what

liens are preserved in bankruptcy; what character of title to the debtor's property is vested in the trustee in bankruptcy; and, as to such property, what rights, remedies, and powers are deemed vested in the trustee. We look to state law to ascertain what property the debtor owned immediately preceding the time of bankruptcy; what liens thereon, if any, then existed; the character thereof; and the order of priority among the respective creditors holding such liens.' "

By far the most significant feature of California law insofar as the rights of creditors (and hence the rights of the trustee) is concerned is that the *California law confers absolutely no rights upon the holder of a void chattel mortgage.* As a result of this situation a creditor (and hence a trustee) has the right to follow the property or its proceeds into the possession of the holder of the chattel mortgage and to recover the same. The leading case in this district is the case of *Chapman v. England* (C. A. 9, 1956), 231 F. 2d 606. In this case a trustee in bankruptcy was held able to reach the proceeds of an insurance policy covering property which had been damaged and upon which the claimant held a void mortgage. The trustee was able to recover these proceeds even though the insurance policy contained the usual loss-payable clause in favor of the mortgagee. Incidentally in this case the mortgage in question was held void for the same reasons as is set forth on the complaint on file herein, *i.e.,* the failure to record after the property had been removed to another county.

The most recent case involving the principles of the case at Bar is the case of *Miller v. Sulmyer* which was

decided in the Court of Appeals for the Ninth Circuit on or about January 16, 1959. (236 F. 2d 513.)

In this case a chattel mortgage was held to be void because the same was not recorded promptly. The court held the mortgage to be wholly void and further held that the trustee was entitled to recover the proceeds which the mortgagee held after repossessing and selling the mortgaged property. The Court of Appeals specifically rejected the mortgagee's argument that repossession before bankruptcy cured the infirmity in the mortgage. Sale and payment logically can give no rights either.

Noyes v. The Bank of Italy (1929), 206 Cal. 266.

See also the case of *Ruggles v. Cannady* (1898), 127 Cal. 290.

The best discussion on the question of possession and the ability of a creditor to reach property even after there had been a foreclosure and sale is the case of *Chelhar v. The Acme Garage* (1936), 61 P. 2d 1232, 18 Cal. App. 2d 775, where the court said on page 779:

> "The mortgage, as to the creditors of the mortgagor, was always void. It continued to be void notwithstanding the fact that the mortgagee assumed to take possession under and to sell the property by virtue of said void instrument. As between these mortgagers and creditors, it was the same as if the mortgage did not exist, and the mortgagee could not, as against those creditors, obtain any rights under it. How could a mortgagee in a void mortgage as against creditors obtain any title to property by virtue of such mortgage? As against them the mortgagee could not rightfully

take the property by virtue of this void instrument, and if she did take it in spite of the fact that the mortgage was void and no protection to her, how could she secure any further or greater right by the sale of the property and the receipt of its value?"

Wherefore, it is respectfully submitted that plaintiff is entitled to summary judgment for the relief requested in the complaint and that the District Court erred in granting defendant's motion to dismiss. The Judgment should be reversed with instructions to enter a Judgment in favor of appellant.

Dated: This 15th day of November, 1960.

WILLIAM J. TIERNAN,

Attorney for the Trustee.